22.05 Example #4 – Noncontrolling Interest

When one entity obtains a controlling financial interest in another entity, it may or may not entail the acquisition of the acquiree's equity securities, such as when a primary beneficiary has a controlling financial interest in a VIE. In addition, even when it does, the acquirer often acquires less than 100% of the acquiree's outstanding stock. The portion of the acquiree's equity that is held by parties or entities other than the acquirer is referred to as the **noncontrolling interest**.

The noncontrolling interest is considered a portion of shareholders; equity and is required to be reported in the shareholders' equity section of the balance sheet. It is originally recognized at fair value as of the date of acquisition:

- If the shares are traded in an active market, the per share market value will be multiplied by the number of shares owned by others.
- If the shares are not traded in an active market, an alternative method will be applied in determining fair value.

The noncontrolling interest is adjusted for:

- The noncontrolling interest's share of the acquiree's net income; and
- The noncontrolling interest's portion of distributions by the acquiree.

The consolidated I/S will include the revenues, expenses, gains, and losses of both the acquirer and the acquiree.

- The I/S effects of interentity transactions, including sales of merchandise, the performance of services, loans, leases, and the sale of other assets, are eliminated.
- The result is considered consolidated net income.
  - A portion, equal to the acquiree's unadjusted net income multiplied by the noncontrolling interest's percentage ownership in the acquiree, is allocated to, and recognized as an adjustment to the noncontrolling interest.
  - The remainder is allocated to the acquirer and recognized as an adjustment to retained earnings.

A similar approach is used in allocating other comprehensive income. The consolidated statement of other comprehensive income, or combined statement if the one-statement approach is used, will reflect all items of other comprehensive income for the period for both the acquirer and the acquiree, after eliminating interentity items, if any.

- A proportionate amount of those attributable to the noncontrolling interest's share is allocated to, and recognized as an adjustment to, the noncontrolling interest.
- The remainder is allocated to the acquirer and recognized as an adjustment to accumulated other comprehensive income.

Class Example #4

Assume that P Co. acquired 90% (10% noncontrolling interest) of the stock of S Co. in an acquisition on 12/31/X1 for a payment of $900 cash. At the date of acquisition, S Co. had 100,000 shares of stock outstanding with an FMV of $8 per share. The book value of S was $600, and all of the assets and liabilities had fair values equal to their book values, with the exception of equipment with a remaining life of 5 years and a fair value $100 higher than book value. The accounts of the two companies at 12/31/X1 are presented in a worksheet, along with the combining entry.

The consolidating worksheet would appear as follows:

Purchase price	$ 900	
FMV	$ 700	FMV increment
BV	$ 600	

The FMV of the noncontrolling interest at the date of acquisition is 100,000 × $8 = $800,000 × 10% = $80,000.

The calculation of Goodwill or Gain is as follows:

Fair value of consideration transferred (cost to the acquirer)	$900,000
+ Fair value of previously held equity interests in acquiree	0
+ Fair value of noncontrolling interest	$ 80,000
(-) Fair value of net identifiable assets of acquiree	($700,000)
Goodwill or Gain from bargain purchase	$280,000

Accounts	P Co	S Co	Debits	Credits	Consol
Cash	100	100			200
Equipment	8,000	500	100		8,600
Inv in S	900			900	--
Goodwill			280		280
$1 CS	(1,000)	(100)	100		(1,000)
APIC	(3,000)	(100)	100		(3,000)
Noncontrol Int.				80	(80)
RE	(5,000)	(400)	400		(5,000)

Keep in mind that the income reported for 20X1 will be the **Acquirer's income only**, since purchases are accounted for prospectively, not retroactively. The acquiree's income (or 90% of it, in the case of a 90% purchase) is included from the date of purchase onward.

To acquire 90% of Investment: (Noncontrolling interest) (In books)

Investment	900	
Cash		900

To consolidate: (On worksheet)

C/S	100		
APIC	100		(100%)
R/E	400		
Equipment	100		
Goodwill	280		
Investment		900	
Noncontrolling int. (minority int.)		80 ($800 FMV x 10%)	